DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PAC 730.31/2002-9

May 9, 2002
02-PAC-037(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Documentation Requirements Under FAR 31.205-33(f)

Summary

FAR 31.205-33(f) contains the following three specific documentation requirements for consultant and professional service costs: (1) evidence of what work was planned to be performed, (2) evidence supporting the invoice, and (3) evidence of what work was actually performed. Consultant and professional service costs are allowable only when supported by adequate evidential matter in each of these three categories. The requirement in the last category is for evidence sufficient to determine the nature and scope of work actually performed and does not always require the actual work product of the consultant. All types of consultant or professional service are subject to the requirements of FAR 31.205-33(f).

Background

We have received several inquiries regarding the FAR 31.205-33(f) documentation requirements for costs relating to consultant or professional services. Some contractors have opined that documentation is required only for one of the three categories listed in FAR 31.205-33(f). Some contractors have also argued that documentation of work performed by attorneys and/or certified public accountants are exempt from the requirements of FAR 31.205-33(f).

Guidance

A. Cost Principle Coverage at FAR 31.205-33(f)

Deliberations on the current cost principle requirements for documentation of consultant costs began with a DCAA proposal to the Defense Acquisition Regulation (DAR) Council on July 8, 1988. The DCAA proposal and the subsequent proposed rule recommended by the Cost Principles Committee required documentation from each of the three categories, but specifically excluded work products covered by attorney-client privilege. The FAR Council did not agree with this exclusion, and its proposed rule, published on October 21, 1988 did not exempt work products covered by attorney-client privilege. In addition, the proposed rule made the three categories of evidence optional instead of mandatory. However, the final rule, effective March 7, 1990, included language to mandate documentation from each of the three categories listed and continued the rejection of industry's position that work products covered by attorney-

client privilege should be exempt from the documentation requirements. This final rule, still in effect, reads as follows:

> (f) Fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (See also 31.205-38(f)). However, retainer agreements generally are not based on specific statements of work. Evidence necessary to determine that work performed is proper and does not violate law or regulation **shall include** –
>
> (1) Details of all agreements (e.g., work requirements, rate of compensation, and nature and amount of other expenses, if any) with the individuals or organizations providing the services and details of actual services performed;
>
> (2) Invoices or billings submitted by consultants, including sufficient detail as to the time expended and nature of the actual services provided; **and**
>
> (3) Consultants' work products and related documents, such as trip reports indicating persons visited and subjects discussed, minutes of meetings, and collateral memoranda and reports. (emphasis added)

As plainly stated in FAR 31.205-33(f), consultant costs are allowable only when adequately supported by evidence from each of the three listed categories. Further, the cost principle does not exclude any particular type of consultant from this requirement.

B. Intent of FAR 31.205-33(f)

The Cost Principles Committee evaluated public comments on the October 21, 1988 proposed rule and reported its recommendations in a report dated March 31, 1989. After evaluation of the public comments, the Cost Principles Committee recommended revisions that are substantially the same as the current FAR language. Therefore, a review of the Cost Principles Committee comments is beneficial to fully understanding the current cost principle coverage. Several quotations from the Cost Principles Committee Report, Case 88-99, dated March 31, 1989 follow.

1. All Three Categories of Evidence Required

> AIA recommended that the three categories of items (agreements, costs, and reports) be made alternative rather than cumulative, i.e., that only one of the areas had to be looked at by the Government.
>
> Committee Comment: *The Committee disagrees. In order to effectively evaluate the propriety or legality of consultant activities, one has to check the agreement, the billings and the output and compare them against each other to ensure that, for instance, the billings make sense in light of the output received. If substantial funds have been paid to a consultant and yet there is little or no evidence of work having been performed by him, then that may be an indication*

that the funds are being provided and employed for suspect purposes (e.g., bribes). It is necessary for Government personnel to look at each of these areas in order to determine that funds are not being spent on questionable activities; the extent is to be determined on a case-by-case basis.

2. Attorney-Client Privileged Material Not Exempted

Several commenters suggested that material subject to the attorney-client privilege (and similar data) be deleted from the work product to be made available for Government review.

Committee Comment: *The Committee had included language exempting attorney-client privilege material in its original draft coverage. It was removed by the DAR Council apparently because of the concern that, with lawyers now involved in many areas of consulting, lobbying and other "non-traditional" legal activities, this exemption would be used as an excuse for not providing support for consulting costs. If the commenters' changes were adopted, it could lead to abuses of the attorney-client privilege. Contractors could avoid providing documentation on the basis that mere involvement of a lawyer creates an attorney-client privilege. While the cost principle cannot override legal privileges granted by the courts, the Committee fears that blanket exemption based on claims of attorney-client privileges would engender abuses such as those described above. We are also concerned that such an exemption might encourage ordinary consulting activities being hidden within arrangements with lawyers or law firms.*

3. Presumption of Inadequate Support

Litton recommended that a new sentence be added at the end of paragraph (h) *[currently paragraph (f)]* to read: "However, the absence of any or all of these examples of acceptable evidence shall not, in itself, operate as a presumption of inadequate support."

Committee Comment: *The Committee disagrees with this recommendation. If one does not have an agreement as to the work to be performed; does not know how the price was determined or is being charged; and does not see any evidence as to what, if any, was in fact performed, it is difficult to see how any conclusion can be drawn other than that there is inadequate support.*

4. Requirements for Evidence Are Mandatory

The DODIG and DCAA recommended that the documentation requirements of paragraph (h) *[currently paragraph f]* be changed from permissive to mandatory. Specifically, language should be changed from: "Such

evidence may include, to the extent necessary to ensure that the work performed is proper and does not violate law or regulation" to "In order to ensure that the work performed is proper and does not violate law or regulation, such evidence shall include, but not be limited to".

Committee Comment: *The intent of this recommended change apparently is to require the the [sic] Government auditors to check the contractor's records in all three areas listed, in addition to other unspecified areas if appropriate. The Committee agrees that all three of the areas set out in paragraph (h) [currently paragraph f] should be reviewed in all cases in order to determine the allowability of costs and the legality and propriety of services provided by the consultants. Accordingly, the Committee has changed the word "may" to "shall" as suggested by DCAA and DODIG. The Committee's revised language still allows the field auditors to expand their review where appropriate. While discussing the recommended language, the Committee came to realize that one cannot really "ensure" that work performed by consultants is proper. Accordingly, the Committee has changed the phrase "in order to ensure that the work performed is proper …" to "in order to determine that the work performed is proper …"*

5. Evidence of the Reasonableness and Legitimacy of the Costs

Committee Comment: …. *The commenters seem particularly concerned about the documentation language and choose to interpret this as a new burden. What onerous requirements does the Government ask to have evidence of? …. The Government is merely asking to review the data that any reasonable business already has. The oral nature of some work in this area apparently causes concern among the contracting fraternity. Aside from the fact that most people who are billing for, in effect their time, are scrupulous about documenting their time for billing purposes, it apparently needs to be reiterated that the Government is looking for evidence of the reasonableness and legitimacy of the costs involved, not documentation of every word uttered. For example, if a person was hired to provide a training session, then the contract, the bill and some evidence – which it should be noted could be oral testimony of one of the students – that the class was in fact given could be sufficient to meet the Government's needs. Allowability of costs has always depended on the contractor being able to demonstrate reasonableness and legitimacy of the costs being submitted; this draft revision merely provides some guidance and clarification in this apparently troublesome area.*

C. Conclusion

The contractor must support all consultant costs with evidence from each of the three categories listed in FAR 31.205-33(f). Although auditors may not substitute their auditor judgment for the explicit requirements of the cost principle, auditor judgment remains important for determining if the evidence provided in each category is adequate. In order to make a well-

reasoned audit opinion on consultant costs, auditors must have sufficient and relevant evidence to determine the nature and scope of the consultant work actually performed. By specific requirement of the cost principle, auditors should not make a determination on the allowability of consultant costs without evidence from all three categories, i.e., (1) evidence of what work is to be performed, (2) evidence supporting the invoice, and (3) evidence of what work was actually performed. For example, the auditor may not use evidence from category 1 to allow the consultant cost in the absence of evidence from the other categories.

Regarding the issue of whether the consultant's work product is always an absolute requirement for cost allowability, we believe that the third category of evidence is intended to require evidential matter in support of what work the consultant actually performed (in contrast to what work is planned to be performed in category one). Although a work product usually satisfies this requirement, other evidence may also suffice. Therefore, if the auditor has sufficient evidence demonstrating the nature and scope of the consultant work actually performed, the FAR 31.205-33(f)(3) requirements are met even if the actual work product (e.g., an attorney's advice to the contractor) is not provided. If the nature and scope of the actual work performed cannot be determined and the contractor refuses to provide the work product, the auditor should question the costs as unallowable under FAR 31.205-33(f). However, the auditor should not insist on a work product if other evidence provided is sufficient to determine the nature and scope of the actual work performed by the consultant.

As we have seen, the documentation requirements are mandatory for consultant costs to be allowable. Thus, if the contractor claims consultant costs in its indirect cost settlement proposal and fails to provide supporting evidence required by FAR 31.205-33(f), the auditor should recommend application of the penalty provided by FAR 42.709.

Concluding Remarks

Please direct any questions or concerns to Karen Cash, Program Manager, Accounting and Cost Principles Division at (703) 767-3251 or Karen.cash@dcaa.mil.

/Signed/
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